

ECONOMIC OUTLOOK

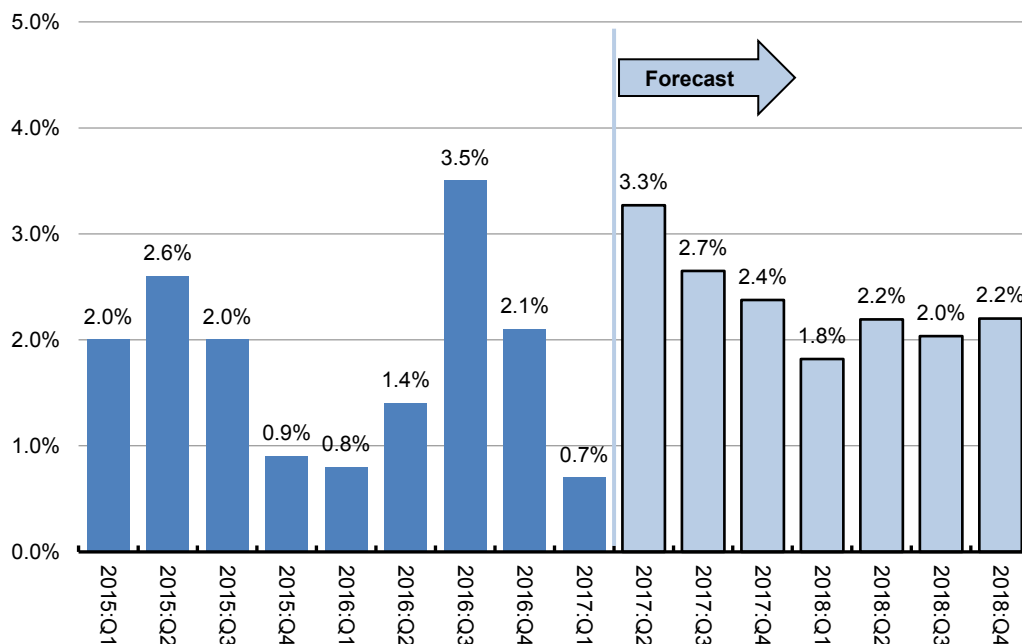
Moderate growth is expected throughout the forecast period, with unemployment rates remaining low and inflation beginning to rise in the U.S. and California. The risk of a stock market correction, an eventual recession, geopolitical events, or housing constraints could lead to disruptions in the economy.

THE NATION – MODERATE GROWTH

The forecast assumes federal tax and spending policies remain relatively constant compared to 2016, with moderate economic growth continuing over the next few years. In 2016, real GDP grew by 1.6 percent, as stronger consumption was offset by weak business investment. Residential building and business investment are expected to pick up, and consumption growth is expected to continue, leading to moderate growth (Figure ECO-01).

The U.S. unemployment rate reached 4.4 percent in April 2017 and was equal to its pre-recession low (Figure ECO-02). This is leading to higher wage growth. Meanwhile, jobs continued to be added at a slower pace, as both the U.S. and California have fewer people looking for work. U.S. inflation was 1.3 percent in 2016 and is expected to exceed 2 percent in 2017 as housing, gas, and medical costs rise. After the interest rate hike in March, the Federal Reserve is expected to continue gradually raising interest rates.

Figure ECO-01
**U.S. Real Gross Domestic Product
 Quarter-to-Quarter Growth, Annualized**



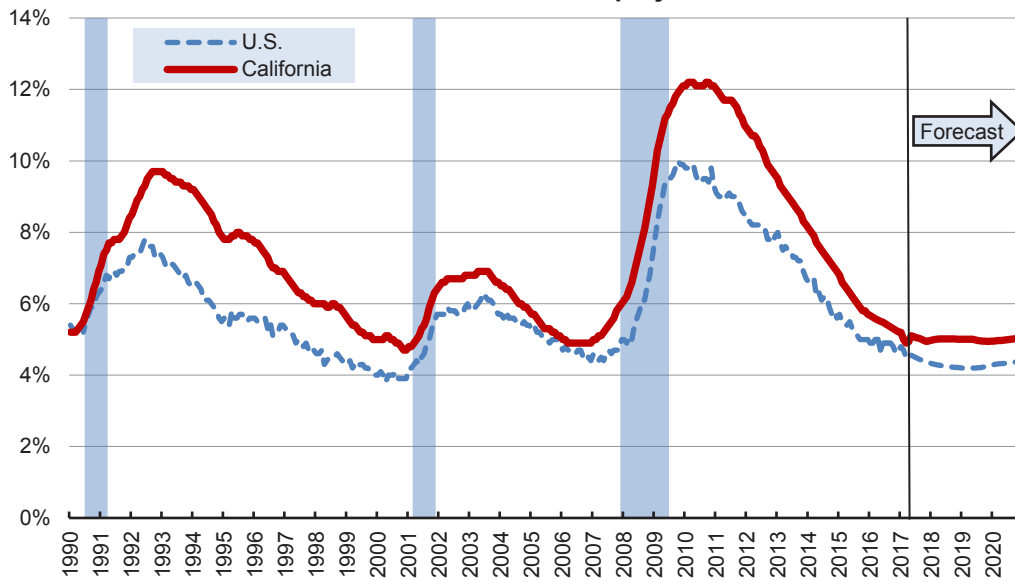
Source: U.S. Bureau of Economic Analysis; CA Department of Finance May Revision Forecast.

CALIFORNIA – SHIFTING GROWTH

California's unemployment rate fell to 4.9 percent in March 2017 and is expected to remain near that level throughout the forecast. With job growth slowing, average wages are starting to rise. The source of personal income growth is shifting from increased employment to higher income per worker. Labor force growth is expected to keep up with job growth, despite increasing numbers of retirees in California.

Consumer inflation is expected to remain higher in California than the nation, with California inflation expected to average 3.0 percent in 2017, and 2.9 percent in 2018 and afterwards. Housing permits issued by local authorities remain well below levels needed to account for population growth, a trend that is expected to continue throughout the forecast. Low levels of housing relative to demand are expected to continue in 2017 and 2018, contributing to faster inflation in the state (Figure ECO-03). The statewide median sales price of an existing single-family home was \$502,250 in 2016, still more than double the national median price of \$235,500. See Figure ECO-04 for highlights of the national and California forecasts.

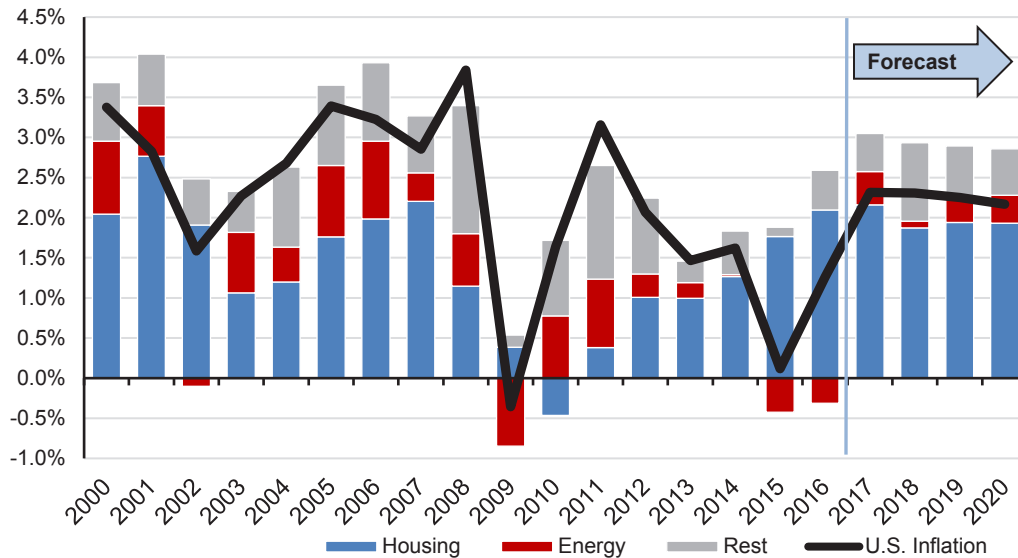
Figure ECO-02
U.S. and California Unemployment Rate



Shaded areas indicate U.S. recessions.

Source: U.S. Bureau of Labor Statistics; CA Employment Development Department, Labor Market Information Division; CA Department of Finance May Revision Forecast.

Figure ECO-03
Housing Costs Forecast to Drive Inflation



Source: U.S. Bureau of Labor Statistics; CA Department of Finance May Revision Forecast.

Figure ECO-04

Selected Economic Indicators

United States	2012	2013	2014	2015	2016	2017 Projected	2018 Projected
Nominal gross domestic product, \$ billions	\$ 16,155	\$ 16,692	\$ 17,393	\$ 18,037	\$ 18,569	\$ 19,440	\$ 20,282
Real gross domestic product, percent change	2.2%	1.7%	2.4%	2.6%	1.6%	2.4%	2.2%
<i>Contributions to real GDP growth</i>							
Personal consumption expenditures	1.0%	1.0%	2.0%	2.2%	1.9%	1.9%	1.8%
Gross private domestic investment	1.5%	1.0%	0.7%	0.8%	-0.3%	0.8%	0.6%
Net exports	0.1%	0.3%	-0.2%	-0.7%	-0.1%	-0.3%	-0.3%
Government purchases of goods and services	-0.4%	-0.6%	-0.2%	0.3%	0.1%	0.0%	0.0%
Personal income, \$ billions	\$ 13,915	\$ 14,074	\$ 14,810	\$ 15,459	\$ 16,012	\$ 16,721	\$ 17,486
Corporate profits, percent change	10.0%	1.7%	5.9%	-3.0%	-0.1%	7.3%	4.0%
Housing permits, thousands	830	991	1,052	1,183	1,190	--	--
Housing starts, thousands	784	928	1,001	1,108	1,176	1,259	1,309
Median sales price of existing homes	\$ 177,200	\$ 197,400	\$ 208,900	\$ 223,900	\$ 235,500	--	--
Federal funds rate, percent	0.1%	0.1%	0.1%	0.1%	0.4%	1.1%	1.7%
Consumer price index, percent change	2.1%	1.5%	1.6%	0.1%	1.3%	2.3%	2.3%
Unemployment rate, percent	8.1%	7.4%	6.2%	5.3%	4.9%	4.5%	4.3%
Civilian labor force, millions	155.0	155.4	155.9	157.1	159.2	160.1	162.0
Nonfarm employment, millions	134.2	136.4	138.9	141.8	144.3	146.6	148.4
California							
Personal income, \$ billions	\$ 1,839	\$ 1,862	\$ 1,978	\$ 2,104	\$ 2,197	\$ 2,295	\$ 2,398
California exports, percent change	1.5%	4.0%	3.4%	-4.9%	-1.1%	--	--
Housing permits, thousands	59	86	86	98	100	106	115
Housing unit net change, thousands	45	59	69	68	89	--	--
Median sales price of existing homes	\$ 319,310	\$ 407,150	\$ 446,890	\$ 476,320	\$ 502,250	--	--
Consumer price index, percent change	2.2%	1.5%	1.8%	1.5%	2.3%	3.0%	2.9%
Unemployment rate, percent	10.4%	8.9%	7.5%	6.2%	5.4%	5.1%	5.0%
Civilian labor force, millions	18.5	18.6	18.7	18.9	19.1	19.3	19.4
Nonfarm employment, millions	14.8	15.2	15.6	16.1	16.5	16.8	17.0
<i>Percent of total nonfarm employment</i>							
Mining and logging	0.2%	0.2%	0.2%	0.2%	0.1%	0.1%	0.2%
Construction	4.0%	4.2%	4.3%	4.6%	4.7%	4.8%	5.0%
Manufacturing	8.5%	8.3%	8.2%	8.1%	7.9%	7.8%	7.7%
High technology	2.4%	2.3%	2.2%	2.2%	2.1%	2.1%	2.1%
Trade, transportation, and utilities	18.5%	18.4%	18.3%	18.3%	18.1%	18.1%	18.0%
Information	2.9%	3.0%	3.0%	3.0%	3.2%	3.2%	3.2%
Financial activities	5.2%	5.2%	5.0%	5.0%	5.0%	5.0%	5.0%
Professional and business services	15.2%	15.4%	15.5%	15.5%	15.4%	15.3%	15.2%
High technology	2.4%	2.4%	2.5%	2.6%	2.6%	2.6%	2.6%
Educational and health services	15.1%	15.2%	15.2%	15.3%	15.4%	15.6%	15.7%
Leisure and hospitality	10.8%	11.1%	11.3%	11.4%	11.5%	11.5%	11.6%
Other services	3.4%	3.4%	3.4%	3.4%	3.4%	3.4%	3.3%
Government	16.1%	15.7%	15.5%	15.3%	15.2%	15.1%	15.1%

Forecast based on data available as of April 2017.

Percent changes calculated from unrounded data.

RISKS TO THE OUTLOOK

The main risks to the California economic outlook are a stock market correction, an eventual recession in the U.S., geopolitical risks that affect U.S. growth, or continued lack of housing in California that limits growth.

This forecast assumes that there are no large changes to federal tax policy. Yet, it appears recent stock market behavior already reflects expected cuts to corporate tax rates. Valuations of companies are relatively high compared with historical benchmarks. Unless the federal government follows through with such a tax cut, the stock market could drop precipitously. This would likely affect investment and hiring decisions at California companies, even in the absence of a recession.

The risk of a U.S. recession also remains. Almost eight years after the end of the last recession, both the U.S. and California are at unemployment rates only seen close to the end of an expansion. The U.S. unemployment rate stayed at or below 4.5 percent for eight out of nine months in late 2006 to early 2007, while the California unemployment rate stayed at 4.9 percent for less than a year before beginning to rise in early 2007. To keep growth on the current path, businesses would have to slow their hiring and wage increases in tandem with slowing consumer demand. Otherwise, inflation will rise further, and imbalances that trigger a recession would result. Large policy changes that might affect economic growth, such as trade, immigration, or government spending, may also cause businesses and individuals to pull back on investment or consumption and cause a recession.

Geopolitical events such as wars in the Middle East, conflicts in Asia, uncertainty about the European Union, or other incidents could also reduce U.S. growth or cause a recession. Many California companies sell their products and services worldwide, and have supply chains that cross many borders. Disruptions to trade or lower demand abroad would reduce California growth.

Finally, California housing growth continues to lag population growth, raising housing costs and potentially limiting the number of jobs that companies can add. In 2016, the state added 89,000 net housing units, but population increased by 335,000. Housing costs are a major component of consumer spending, and have also been increasing faster than inflation since 2012, a trend that is expected to continue. While the forecast assumes that increasing numbers of permits will be issued by local authorities, if permits remain low, it will reduce the number of available workers in those areas.